Solution 15.1

Journals	Debit	Credit
30 May 20X4		
Bank (10 000 x 6)	60 000	
Ordinary shares (10 000 x 1)		10 000
Share premium (balancing)		50 000
Rights issue at C6 (market price of C9)		
Share premium	15 000	
Bank		15 000
Share issue expenses written off		
Share premium (30 000 + 50 000 – 15 000)	65 000	
Retained earnings (balancing)	47 000	
Ordinary share capital (112 000 x C1)		112 000
Capitalisation issue of ordinary shares *112 000 (W1) x C1 PV = 112 000*		

W1: Number of shares issued in terms of the capitalization issue		**Actual**
Opening balance		270 000
Rights issue		10 000
		280 000
Capitalisation issue	*280 000 / 5 x 2*	112 000
Closing balance		392 000

Solution 15.2

a)

WOLVERINE LIMITED
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 MARCH 20X3

	Share capital	Share premium	Preference share capital	Non distributable reserve	Retained earnings	Total
	C	C	C	C	C	C
Balance at 31 March 20X1	1 800 000	150 000	500 000	100 000	9 500 000	12 050 000
Share issue on 1 July 20X1	200 000	40 000	-	-	-	240 000
Share issue expenses	-	(10 000)	-		-	(10 000)
Total comprehensive income	-	-	-	-	930 000	930 000
Preference dividend declared	-	-	-	-	(60 000)	(60 000)
Balance at 31 March 20X2	2 000 000	180 000	500 000	100 000	10 370 000	13 150 000
Capitalisation issue	500 000	(180 000)	-	-	(320 000)	-
Total comprehensive income	-	-	-	50 000	1 100 000	1 150 000
Ordinary dividend declared	-	-	-	-	(125 000)	(125 000)
Preference dividend declared	-	-	-	-	(60 000)	(60 000)
Balance at 31 March 20X3	2 500 000	-	500 000	150 000	10 965 000	14 115 000

b)

WOLVERINE LIMITED
EXTRACT OF NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 MARCH 20X3

3. Earnings per share

Earnings per share is based on earnings of C 1 040 000 (20X2: 870 000) and on a weighted average of 2 500 000 shares (20X2: 2 437 500). There was a capitalisation issue during the year of 1 share for every 4 shares held. Comparative number of shares have been restated.

	20X3	20X2
Profit for the period	1 100 000	930 000
Preference dividend declared	(60 000)	(60 000)
Earnings	1 040 000	870 000

Solution 15.2 continued . . .

4. Share capital

Authorised
5 000 000 ordinary shares of C1 each.
100 000 12% non-cumulative preference shares of C5 each.

Issued	**20X3**	**20X2**
	C	**C**
2 500 000 ordinary shares of C1 each	2 500 000	
2 000 000 ordinary shares of C1 each		2 000 000
100 000 12% non-cumulative preference shares of C5 each	500 000	500 000

50 000 shares were taken up by the directors wives in 20X2.

In terms of members resolution 101, the un-issued shares are under the unrestricted control of the directors until the next annual general meeting.

Reconciliation of number of shares

	Ordinary	**Preference**
Balance at 01 April 20X1	1 800 000	100 000
Share issue on 1 July 20X1	200 000	-
Balance at 31 March 20X2	2 000 000	100 000
Capitalisation issue on 31 December 20X2	500 000	-
Balance at 31 March 20X3	2 500 000	100 000

Workings: Weighted average number of shares

		Total	**20X3**	**20X2**
01/04/X1	Balance	1 800 000	1 800 000	1 800 000
01/07/X1	Share issue (X2 : X 9/12)	200 000	200 000	150 000
31/03/X2	Balance	2 000 000	2 000 000	1 950 000
31/12/X2	Capitalisation issue	500 000	500 000	487 500
31/03/X3	Balance	2 500 000	2 500 000	2 437 500

Solution 15.3

KLAUS LIMITED
EXTRACT FROM STATEMENT OF FINANCIAL POSITION
AS AT 30 JUNE 20X5

		Note	20X5 C	20X4 C
EQUITY & LIABILITIES				
Capital and reserves				
Share capital	215 000 + 73 600	2	258 880	215 000
Preference shares			0	100 000
Distributable reserves – retained earnings	140 000 – 3 000		140 000	X
Share premium account			26 720	15 000
Non-current liabilities				
C1 debentures		3	29 400	0

KLAUS LIMITED
(EXTRACT FROM) STATEMENT OF CHANGES IN EQUITY
AT 30 JUNE 20X5

	Ordinary stated capital C	Preference share capital C	Retained earnings C	Share premium account	Total C
(Preliminary) Balance 30/6/X5	200 000	100 000	140 000	15 000	455 000
Shares issued during the year	58 880			14 720	73 600
Preference shares redeemed		(100 000)			(100 000)
Premium on redemption written off				(3 000)	(3 000)
Balance 30/6/X5	258 880	0	140 000	26 720	425 600

Solution 15.3 continued

EXTRACT FROM THE NOTES TO THE FINANCIAL STATEMENTS

2. Share capital

Authorised
300 000 ordinary shares of no par value
100 000 16% preference shares of C1 each

Issued

	Ordinary Number	Preference Number
Number of shares in issue at beginning of year	200 000	100 000
Issued during the year *(W1)*	58 880	
Redeemed during the year		(100 000)
Number of shares in issue at end of year	258 880	-

3. Non-current liabilities

30 000 debentures of C1 each	30 000
Debenture discount unamortised	(600)
	29 400

Workings

W1 Financing

Cash needed (100 000 + 3 000)	103 000
Cash resources	
- Debentures (30 000 x 0.98)	29 400
- Fresh issue required (103 000 – 29 400)	***73 600***
	103 000
Issue price	
Number of shares issues (73 600 / 1.25)	58 880

W2 Premium written off	3 000
- Retained earnings	3 000
- Share premium	-

Solution 15.4

a) Calculation of number of shares to be issued

Cash required		
Preference shares	120 000 x C0.50	60 000
Premium	120 000 x C0.05	6 000
Dividend	(15% x 120 000 x C0.50 x 4/12)	3 000
		69 000
Cash		
Balance 29/4/X9	given	8 000
Share issue expenses		(1 200)
		6 800
Balance to remain		(3 000)
Cash available before loan		3 800
Loan raised		40 000
Cash available after loan		43 800
Cash required		(69 000)
Shortage of cash to be resolved through share issue		**25 200**
Share price		2.50
Number of shares	(25 200 / C2.50)	10 080

b) Proof that scheme will fulfill directors' requirements

Retained earnings		
Balance 30/4/X9		120 000
		(5 160)
Dividend	120 000 x 0.50 x 15% x 4/12	(3 000)
Premium on redemption	W1	(960)
Share issue expenses	Given	(1 200)
Balance		114 840
Less balance to remain		(70 000)
Excess profits available	(therefore the plan works)	44 840

If 10 080 shares are issued then a balance of C3 000 will remain on the cash account and a balance in excess of C70 000 will remain on the retained earnings account. Therefore, the directors' requirements are met.

Workings

W1: Premium		6 000
- Share premium	(10 080 x C0.50)	5 040
- Retained earnings	(Balancing because directors want to use share premium to maximum extent possible)	***960***

Solution 15.5

a) Effective interest rate table: 14.808368%

	Interest	Payments/ Dividends	Premium accrued	Balance
01/01/20X1				3 000 000
31/12/20X1	444 251	(300 000)	144 251	3 144 251
31/12/20X2	465 612	(300 000)	165 612	3 309 863
31/12/20X3	490 137	(300 000)	190 137	3 500 000
		(3 000 000)	(500 000)	0
	1 400 004	(3 900 000)	0	0

b) Statement of financial position disclosure

YUSUF LIMITED
STATEMENT OF FINANCIAL POSITION
AT 31 DECEMBER 20X2

	20X2 C	20X1 C
EQUITY AND LIABILITIES		
Non-current liabilities		
Preference shares	0	3 144 251
Current liabilities		
Preference shares	3 309 863	0

c) Calculation of number of shares to be issued:

Cash required:		
Redemption of preference shares	Excludes the preference dividends of 300 000 because these are to be paid out of currently available cash resources	3 500 000
Cash raised:		
Loan		1 800 000
Cash still needed		1 700 000
Issue price per share		2.50
Number of shares to be issued		680 000

Solution 15.5 continued …

d) Journals

	Debit	Credit
Interest (expense) *(per (a) above)*	490 137	
Preference shares (liability)		190 137
Bank		300 000
Effective interest and dividend payment		
Preference shares (liability)	3 500 000	
Preference shareholders (current liability)		3 500 000
Preference share capital and dividends to be redeemed		
Preference shareholders (current liability)	3 500 000	
Bank *(per (c) above)*		3 500 000
Redemption of preference shares		
Bank *(per (c) above)*	1 800 000	
Loan (liability)		1 800 000
Raising of loan		
Bank *(per (c) above)*	1 700 000	
Share capital (equity)		1 360 000
Share premium (equity)		340 000
Issue of ordinary shares		
Share premium (equity)	20 000	
Bank		20 000
Share issue costs written off against share premium		

Working

Share premium	500 000
Share premium	0
Retained earnings	500 000

Note: The question stated that the premium on redemption is to be set off against profits. As the preference shares were classified as a liability, finance charges using the effective interest rate method already allocated the premium to profit and loss, and thus no additional journal is necessary for the transfer to retained earnings.

Solution 15.6

JOURNAL

Date	Description	Debit	Credit
20Y0			
	Interest expense (Preference share dividend)	12 140	
	Preference shares (NCL) *(W5)*		2 140
	Preference shareholders (CL)		10 000
	Dividend for the year& premium accrued		
	Preference share	110 000	
	Preference shareholders	10 000	
	Bank		120 000
	Bank *(W6)*	24 000	
	Share capital		24 000
	10 000 ordinary shares issued at C2.40 per share		
	Bank *(W6)*	96 000	
	10% debentures (NCL)		96 000
	10% Debentures issued: 9 600 x C10 each		

Solution 15.6 continued …

Workings

W1 Fresh issue of shares required

Authorised shares		310 000
Issued shares		(300 000)
Fresh issue of shares		10 000

W2 Financing

Cash needed	(capital: 50 000 x C2.20 + dividend: 50 000 x C2 x 10%)	120 000
Cash resources from:		
- Fresh issue of ordinary shares	10 000 (W1) X C2.40	24 000
- Fresh issue of debentures required	(balancing)	***96 000***
		120 000

W3 Premium to be set off against:	50 000 x C0.2	
- Retained earnings	(already done via interest charge)	10 000

W4 Cash flow

	Inflow/ (outflow)	Calculations
1/1/X5	100 000	
31/12/X5	(10 000)	50 000 x C2 x 10%
31/12/X6	(10 000)	50 000 x C2 x 10%
31/12/X7	(10 000)	50 000 x C2 x 10%
31/12/X8	(10 000)	50 000 x C2 x 10%
31/12/X9	(10 000)	50 000 x C2 x 10%
31/12/Y0	(120 000)	50 000 x C2 x 10% + 50 000 x C2.20

The effective interest rate is 11.25563551% (using a financial calculator).

W5 Preference shares

	Interest	Dividend	Premium	Premium balance	PV
1/1/X5					100 000
31/12/X5	11 256	(10 000)	1 256	1 256	101 256
31/12/X6	11 397	(10 000)	1 397	2 653	102 653
31/12/X7	11 554	(10 000)	1 554	4 207	104 207
31/12/X8	11 729	(10 000)	1 729	5 936	105 936
31/12/X9	11 924	(10 000)	1 924	7 860	107 860
30/12/Y0	12 140	(10 000)	2 140	10 000	110 000
	70 000	60 000			

Solution 15.7

RFK LIMITED
STATEMENT OF FINANCIAL POSITION
AT 28 FEBRUARY 20X5

			20X5	20X4
EQUITY AND LIABILITIES		**Note**	**C**	**C**
Capital and reserves		2	1 168 200	995 000
Non-current liabilities				
Debentures	W1		25 000	0
Current liabilities				
12% Redeemable preference share capital	W5		-	155 620
Bank overdraft	(30K + 9K + 18K)		57 000	xxx
Current tax payable			30 670	

RFK LIMITED
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 28 FEBRUARY 20X5

	Ordinary share capital	Share premium	Retained earnings	Total
	C	**C**	**C**	**C**
Balance 1/3/X4	400 000	480 000	115 000	995 000
Ordinary shares issued during year	106 000	26 500		132 500
Share issue expenses written off		(9 000)		(9 000)
Total comprehensive income			49 700	49 700
Transfer of premium on redemption from share premium		(7 500)	7 500	0
	506 000	490 000	172 200	1 168 200

Solution 15.7 continued …

EXTRACT FROM NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 28 FEBRUARY 20X5

1. Accounting policies

Preference shares

Preference shares, which are redeemable at the option of the shareholder, are presented as long-term liabilities, as they are in substance borrowings. The dividends on such preference shares are recognised in the statement of comprehensive income as interest expense on the effective interest rate basis basis.

2. Ordinary shares

Authorised

1 000 000 ordinary shares of C1 each	1 000 000

Issued

	R
506 000 shares of C1 each	506 000

	Quantity
Number of shares in issue at the beginning of the year	400 000
Number of shares issued during the year	106 000
Number of shares in issue at the end of the year	506 000

The directors have been granted permission to issue the unissued ordinary shares at their sole discretion. Such authority is exercisable until the next annual general meeting.

2. Redeemable preference shares

Authorised	**C**
100 000 12% redeemable preference shares of C2 each	200 000

Issued	**Quantity**
Number of shares in issue at the beginning of the year	75 000
Shares redeemed during the year	(75 000)
Number of shares in issue at the end of the year	-

The preference shares were redeemed, at the option of the shareholders, on 28 February 20X5 at a premium of C0.10 per share. The 12% preference dividends are cumulative. The effective interest rate is 12.7750262%.

Solution 15.7 continued . .

Workings

W1 Cash required from issue of ordinary shares

		C
Redemption of 75 000 12% preference shares at C2.00 each		150 000
Premium of C0.10 per share		7 500
		157 500
Cash received from debenture issue	100 x C250	(25 000)
Cash required from issues of shares		132 500

∴ Number of shares to be issued $\frac{C132\ 500}{C1.25}$ = 106 000

Note: the issue expenses and preference dividends will be financed by utilising the bank overdraft.

W2 Share premium

Premium	
- Share premium*	7 500
- Retained earnings	-
	7 500

*	Debit	Share premium	7 500	
	Credit	Retained earnings		7500

Reversing the effect of the premium portion of the interest charge to share premium (because the directors want maximum distributable reserves).

W3 T-accounts

ORDINARY SHARE CAPITAL			
Description	**C**	**Description**	**C**
		Balance	400 000
		Bank	106 000
Balance	506 000		
	506 000		506 000
		Balance	506 000

SHARE PREMIUM			
Description	**C**	**Description**	**C**
Share issue expenses	9 000	Balance	480 000
Retained earnings	7 500	Bank	26 500
Balance	490 000		
	506 500		506 500
		Balance	490 000

RETAINED EARNINGS			
Description	**C**	**Description**	**C**
		Balance	115 000
		Profit and loss (W4)	49 700
Balance	172 200	Share premium	7 500
	172 200		172 200
		Balance	172 000

Solution 15.7 continued …

W4 Profit for the period

Profit before finance charges and tax		98 000
Finance charges	W5	(19 880)
Profit before tax		78 120
Tax expense	W6	(28 420)
Total comprehensive income		49 700

W5 Preference shares

Cash flow		
1/3/X0	150 000	
28/2/X1	(18 000)	
28/2/X2	(18 000)	
28/2/X3	(18 000)	
28/2/X4	(18 000)	
28/2/X5	(175 500)	(157 500 + 18 000)

	Interest 12,775%	Dividend	Premium	Premium balance	PV
28/2/X0					150 000
28/2/X1	19 163	(18 000)	1 163	1 163	151 163
28/2/X2	19 311	(18 000)	1 311	2 474	152 474
28/2/X3	19 479	(18 000)	1 479	3 953	153 953
28/2/X4	19 667	(18 000)	1 667	5 620	155 620
28/2/X5	19 880	(18 000)	1 880	7 500	157 500
	97 500	(90 000)			

W6 Tax calculation

Profit before tax		78 120
Permanent differences:		
Finance charge		19 880
Taxable profit		98 000
Tax at 29%	*(98 000 x 29%)*	28 420

Solution 15.8

		Debit	Credit
Interest expense	(53 770 x 11.5870684%)	6 230	
Bank			5 000
Preference share liability			1 230
Recording of preference dividend paid			
Preference dividends		5 000	
Bank			5 000
Preference dividend paid			
Preference share liability		50 000	
Preference shareholders			50 000
Redemption of preference shares			
Bank		22 500	
Share capital			15 000
Share premium			7 500
Issue of ordinary shares (55 000 – 32 500 cash)			
Share issue expenses		2 750	
Bank			2 750
Share issue expenses			
Share premium		2 750	
Share issue expenses			2 750
Write-off of share issue expenses against share premium			
Share premium		5 000	
Retained earnings			5 000
Premium offset against share premium			
Preference shareholders		55 000	
Bank			55 000
Payment of preference shareholders			

(b)

Tax expense			**C**
Current	[(120 000 + 6 230 interest) X 0.29]		36 607
Deferred			-
			36 607
Tax rate reconciliation		**%**	
Tax expense on profit		29.0	34 800
On amortization of preference shares		1.5	1 807
		31.5	36 607

Workings

Financing requirements		
Nominal value	(50 000 X C1)	50 000
Premium on redemption	(50 000 X C0.10)	5 000
		55 000
Cash reserves		(32 000)
Issue of ordinary shares		22 500

Solution 15.9

a) Definitions:

i) Liability:
- Present obligation of the entity
- As a result of a past event
- The settlement of which will result in an outflow of future economic benefits.

ii) Equity:
- The net increase in assets after deducting liabilities

iii) Expense:
- A decrease in economic benefits
- During the accounting period
- Through an increase in liabilities or decrease in assets
- Resulting in a decrease in equity, other than a distribution to equity participants.

b) Discussion: Recognition

i) Recognition of the initial issue of preference shares:

Liability:
- Since Keeptrying Ltd's preference shares are compulsorily redeemable, they represent a present obligation of the entity.

- The past event is the issue of these shares on 1 January 20X3.

- The settlement of this obligation will result in an outflow of cash of C420 000 (in respect of the par value of the shares: C300 000, the premium: C30 000 and the annual dividends: C30 000 x 3 years = C90 000).

The preference shares therefore meet the definition of a liability.

Equity:
- Since bank (an asset) and preference shares (a liability) were both increased, there is no impact on equity.

ii) Recognition of the redemption of preference shares:

Expense:
- A decrease in economic benefits: cash outflow

- During the accounting periods: 20X5

- Through an increase in liabilities or decrease in assets: decrease in bank (i.e. an asset decreased).

Solution 15.9 continued . . .

- Resulting in a decrease in equity, other than a distribution to equity participants**:**
  - Since the issue of the preference shares represents a liability, none of the payments to the preference shareholders represent distributions to equity participants.
  - Since the par value of the shares and premium on redemption are both committed to on the date that the preference shares are issued and are thus recognised as liabilities, the repayment of each represents a decrease in assets (decrease in the bank account) and a decrease in this preference share liability balance, with the result that there is no impact on the equity. These repayments are therefore not expenses
  - The C300 000 paid is a settlement of the original liability
  - The C30 000 paid is a settlement of the premium that accrued over the 3 years.
  - Both the above payments thus decrease liabilities and, at the same time, decrease the assets (bank) with the result that the payments do not represent expenses.

c) Calculation: Measurement

Effective interest rate table	Interest	Bank	Premium accrued	Preference share liability
	12.937%			
				300 000
31/12/20X3	38 811	(30 000)	8 811	308 811
			8 811	
31/12/20X4	39 951	(30 000)	9 951	318 762
			18 762	
31/12/20X5	41 238	(30 000)	11 238	330 000
			30 000	
31/12/20X5		(330 000)	(30 000)	0
	120 000	(420 000)		

- Liabilities should be recognised at the present value of the future obligation (future obligation is C420 000):
  - C318 762 at 31 December 20X4.

d) Correcting journals:

		Debit	Credit
1 January 20X4	Preference share (equity)	300 000	
	Preference share (liability)		300 000
	Correction: recognition of preference shares as a liability		
1 January 20X4 ***	Retained earnings	8 811	
	Preference share (liability)		8 811
	Correction: preference dividend & premium recognised as interest expense		

Solution 15.9 continued . . .

The correct journal entries would have been processed in prior years as follows:

		Debit	Credit
1 January 20X3	Preference share (equity)	300 000	
	Preference share (liability)		300 000
	Correction: recognition of preference shares as a liability		
31 December 20X3 ***	Finance charges *(per (c) above)*	38 811	
	Preference dividend		30 000
	Preference share (liability)		8 811
	Correction: preference dividend & premium recognised as interest expense (see alternative journal below)		
31 December 20X4	Finance charges *(per (c) above)*	39 951	
	Preference dividend		30 000
	Preference share (liability)		9 951
	Correction: preference dividend & premium recognised as interest expense		
31 December 20X4	Preference share (liability)	318 762	
	Preference shareholders (current liability)		318 762
	Correction: recognition of preference shares as a current liability		